



## INDONESIA: ECONOMIC AND FINANCIAL HIGHLIGHTS AUGUST - SEPTEMBER 2006

### Summary:

- Indonesia's GDP growth picked up in the second quarter of 2006 to 5.2% year-on-year (YoY), largely due to a surge in government spending coupled with solid export growth.
- Consumer price inflation slowed to 14.55% in September on a YoY basis, compared to 14.9% in August.
- Bank Indonesia (BI) cut its policy rate by 50 basis points on September 5 and October 5, bringing the BI rate to 10.75%.
- Government of Indonesia (GOI) bond auctions on August 22, September 19 and October 10 raised Rp 9.5 trillion (USD 1 billion) in funds.
- The GOI also swapped Rp 4.7 trillion (USD 504 million) of bonds in August and September as part of its bond re-profiling program.
- The GOI signed a EUR 12.5 million (US \$16 million) debt-swap agreement with Germany on August 3.
- On August 30-31, the Capital Markets and Financial Institutions Authority (BAPEPAM-LK) issued new regulations setting out a licensing and examination system for mutual funds sales agents and procedures for resolving insolvent insurance companies.
- On October 1, President Susilo Bambang Yudhoyono reportedly signed an amendment to a 2005 Government Regulation that will allow state-owned banks to write-off bad loans.
- On September 6, state Asset Management Company (PPA) sold the GOI's 25.9% remaining shares in Bank Permata to Astra International and Standard Chartered Bank Consortium for Rp 1.8 trillion (USD 196 million).
- Indonesia's largest state-owned bank, Bank Mandiri, announced on August 31 that some of its largest debtors had begun paying off their loans.
- At a September 12 hearing, Parliament approved a Rp 1.45 trillion (US \$158 million) capital injection for state owned airlines Garuda Indonesia and Merpati Nusantara.

### GDP Growth Picks Up in the Second Quarter

On August 14, the Central Bureau of Statistics (BPS) announced that Indonesia's economy grew by 5.2% YoY in the second quarter of 2006, compared with a 4.6% gain in the first quarter. An acceleration in agriculture (5% YoY), mining (5.4%) and construction (8.3%) drove growth in the quarter, while manufacturing was largely flat at

just over 3% YoY. Government spending surged during the second quarter by 31.5% YoY, following a 14.2% rise in the first quarter YoY. Nevertheless, government expenditure remained lower than targeted in the first half of the year. Private consumption growth eased slightly to 3% from 3.2% in the January-March quarter. Indonesia's exports rose by 11.3% in the second quarter compared with a 10.8% gain in the previous quarter. This was partially offset by a pick-up in import growth, to 8.3% in the second quarter. Investment growth was negative for the first time in two-and-a-half years, by -1% YoY, likely due to high interest rates.

#### **Indonesian YoY Real GDP Growth:**

<b>A. By Production Category</b>	<b>% Change Q2-06 vs Q2-05</b>	<b>% Change Q1-06 vs Q1-05</b>	<b>Share of GDP Q2-06</b>
Manufacturing	3.1	2.0	28.9
Agriculture	5.0	3.9	13.3
Retail, Hotel, Restaurant	4.6	4.2	14.9
Mining	5.4	7.0	10.5
Services	5.9	5.4	9.8
Finance and Leasing	5.1	5.1	8.2
Construction	8.3	7.2	6.5
Transportation and Communication	13.3	11.0	7.0
Electricity, Gas, Water	5.7	5.2	0.1
<b>TOTAL (categories weighted)</b>	<b>5.2</b>	<b>4.6</b>	<b>100.0</b>

<b>B. By Expenditure Category</b>	<b>% Change Q2-06 vs Q2-05</b>	<b>% Change Q1-06 vs Q1-05</b>	<b>Share of GDP Q2-06</b>
Private Consumption	3.0	3.2	58.3
Government Expenditure	31.4	14.2	8.3
Investment	-1.0	2.9	21.2
Exports	11.3	10.8	44.0
Imports	8.3	5.1	36.2

*Source: Central Bureau of Statistics (BPS)*

#### **Inflation Eases Further in August**

On October 2, the Central Bureau of Statistics (BPS) announced that Indonesia's month-on-month (MoM) inflation increased slightly to 0.38% in September with the beginning of the Muslim fasting month compared with 0.33% in August. However, YoY inflation for the month eased for a fourth consecutive month to 14.55%, the lowest reading in a year. All components of the consumer price index except foodstuffs and education demonstrated slower price growth in September compared to August. Core inflation went up by 0.35% MoM, and 9.13% YoY in September, compared to August's 0.78% and 9.68% respectively. Though demand for goods and transportation traditionally increases due to Muslim and Christian holidays in the fourth quarter, analysts remain optimistic that YoY inflation will fall to 7% by the end of 2006.

### CPI Components

Components	August		September	
	MoM	YoY	MoM	YoY
Food stuff	-0.34	15.22	0.62	15.45
Food, beverages, tobacco, cigarettes	0.35	11.41	0.13	10.28
Housing, water, electricity, oil/gas	0.30	12.48	0.28	12.26
Clothing	0.35	9.47	-0.13	8.05
Health	0.33	6.85	0.31	6.27
Education, recreation, and sport	4.77	9.27	1.84	9.72
Transportation, communication, financial services	0.01	30.70	-0.01	30.15
<b>TOTAL</b>	<b>0.33</b>	<b>14.90</b>	<b>0.38</b>	<b>14.55</b>
<b>Core Inflation *</b>	<b>0.78</b>	<b>9.68</b>	<b>0.35</b>	<b>9.13</b>

Source: Central Bureau of Statistics (BPS)

\* Core inflation is a measure of inflation which excludes certain items that face volatile price movements i.e. energy, food products.

### Interest Rate Cut to 10.75%

At its monetary policy meeting on October 5, BI cut its policy rate 50 basis points to 10.75% on top of a previous 50 basis points cut on September 5. Markets expect interest rates to continue to fall during the remainder of 2006 as inflationary pressures subside. The Director of the Office of the Governor at BI said there is room for more interest rate cuts later this year due to an expected further easing in inflation.

### GOI Issues Long-Term Bonds

The Government of Indonesia (GOI) completed its rupiah bond offerings for 2006 with bond auctions on August 22, September 19, and October 10 that raised a total of Rp 9.5 trillion (USD 1 billion) for the budget. The three auctions brought the total amount of government bonds issued this year to approximately Rp 60.9 trillion (US \$6.6 billion), with a net issuance (new issues minus amortizations) of Rp 35.8 trillion (US \$3.9 billion). Details on the three auctions follow:

- On August 22, the Ministry of Finance (MOF) issued Rp 1.95 trillion (US \$212 million) of 12-year bonds and Rp 4.175 trillion (US \$454 million) of 17-year bonds. The bonds offer 11.82% and 11.95% average yield, respectively.
- On September 19, MOF sold rupiah-denominated Government Bonds with an overall value of Rp 2.4 trillion (US \$261 million). The bonds offer a fixed rate with an 11% semi-annual coupon, maturing in 2025.

- On October 10, MOF held its last bond auction for 2006 by selling Rp 1 trillion (US \$109 million). The bond holds 9.25% coupon rate and will mature on in 2008.

### **GOI Continues Debt Swap Program**

An August 8 MOF offer to swap Rp 4.4 trillion (US \$478.5 million) worth of bonds maturing 2007-2009 for 15-year debt drew a good response, after Bank Indonesia slashed its benchmark rate by half a percentage point. The 15-year bonds were priced to yield 12.03%, significantly below a the 12.41% yield for 15-year bonds auctioned on July 25, reflecting strong demand. Subsequent debt swaps on August 29 and September 26 were less successful, with the GOI exchanging only a small amount of bonds.

### **Indonesia and Germany Agree On Debt Swap**

On August 3, Germany and Indonesia agreed on a EUR 12.5 million (USD 16 million) debt-for-environment swap under which the GOI committed to spend approximately Rp 60 billion (US \$7 million) to establish a revolving fund for investment in environment-friendly technology. Selected Indonesian banks will administer the fund and channel it into micro and small enterprises, especially those facing difficulties in obtaining bank loans. In return, Germany will cancel outstanding debts amounting to twice the sum spent by Indonesian government. Germany will also provide EUR 10 million (US \$12.8 million) to build a hospital in South Sulawesi province. EUR 1 million (US \$1.3 million) of this assistance is in grant form, with the rest in the form of a loan carrying a 0.75% interest rate with 10-year grace period.

### **New Regulations for Mutual Funds, Insurance Companies**

As part of the government's financial sector reform policy package (Ref A), the Financial Institution and Capital Markets Supervisory Board (BAPEPAM-LK) issued three new regulations concerning mutual fund sales agents on August 31. The regulations seek to improve the professionalism of mutual fund sales agents and representatives by requiring a licensing, examination and registration system.

On August 31, BAPEPAM-LK also issued a decree on insolvent insurance companies outlining the GOI's strategy for managing insolvent insurance and reinsurance companies. The decree contains a) sanctions for companies that do not meet solvency requirements; b) procedures for submission of insurance company restructuring plans to the MOF's Insurance Bureau and; c) requirements during the restructuring transition period. Observers have noted that some of Indonesia's small domestic insurers are in poor financial condition and may need closer supervision.

### **State Banks Can Write Down NPLs**

On October 1, Coordinating Minister for the Economy Boediono said that President Susilo Bambang Yudhoyono had amended Government Regulation No. 14/2005 on the

procedures for treating debts to state-owned institutions. The new decree reportedly will allow state banks to write-off bad loans independently without a lengthy approval process requiring the assent of the MOF, the President and the Parliament (depending on the size of the debt). State bank loans will no longer be treated as state assets. This will allow state banks discretion similar to private banks in restructuring, re-negotiating and writing down non-performing loans. The amendment is part of the GOI's July 2006 financial sector reform package.

### **GOI Divests Shares in Bank Permata**

A Consortium of PT Astra International and Standard Chartered Bank acquired a 25.9 percent stake in Bank Permata from the state asset management company PT Perusahaan Pengelola Aset (PPA) on September 6 for (Rp 1.8 trillion (USD 197 million). PPA sold Bank Permata at a price of Rp 875 per share. The final transaction price values the banks at 2.64 times PBV based on December 31, 2005 financial statement. The acquisition increases the consortium's stake in Permata from 63.1% to 89%. Under the terms of the consortium agreement, SCB and Astra each own 44.5% of Permata. Permata is Indonesia's seventh largest bank by assets and has more than 310 branches, a million customers and total assets of Rp 36.6 trillion (US \$4 billion) as of June 2006.

### **Remaining GOI Shares in Banks**

<b>Bank/</b>	<b>%</b>
Bank Internasional Indonesia	5.52
BTPN	28.4
Maybank Indocorp	6.1
Lippo	0.012
Panin	0.002

*Source: PPA*

### **Mandiri's Big Debtors Start Repaying**

On August 31, state-owned Bank Mandiri announced that a number of its biggest debtors have committed to speeding up repayment of their loans. In June 2006, the bank had publicized the names of 30 corporate borrowers with non-performing loans exceeding Rp 1 trillion each (US \$109 million). The total loans to this group accounted for 60% of Mandiri's NPLs, which reached Rp 27 trillion (US \$2.9 billion) as of December 2005, or 26.2% of its total loans. The table below shows the status of some of the big debtors.

### **Mandiri's Debt Settlement Status**

<b>Company</b>	<b>Amount of Liability (1)</b>	<b>Status</b>
Mahakam Polyboa (2)	147.4	Performing (paying installment and interest).
Sungai Budi (3)	673.8	Paid.
Sulfindo (4)	600.0	Paid.
Domba Mas (5)	1,993.4	US \$90 million paid. Remaining to be paid in Q4 2006.
Flora Sawita (6)	680.4	Will pay in Q4 2006.
Esterindo (7)	567.3	Performing (paying installment and interest).
APAC (8)	646.6	Performing (paying installment and interest).
Argo Pantes (9)	2,317.6	Asset transfer.
Pacific Andes (10)	US \$85 million	US \$57 million paid. Remaining to be paid in Q4 2006.

*Source: Bank Mandiri*

*(1) As of March 2006, in Rp billion unless stated otherwise.*

*(2) Management consulting services.*

*(3-7) Chemical manufacturer*

*(8-9) Textile manufacturer*

*(10) Fish trading company*

### **Parliament Approves Capital Injection for State-Owned Airlines**

At a September 12 hearing, Parliament approved Rp 1 trillion (US \$109 million) and Rp 450 billion (US \$49 million) capital injections for state owned airline companies Garuda Indonesia and Merpati Nusantara, respectively. According to the budget committee chairman Max Moein, the capital injection will be obtained from privatization proceeds this year, targeted at Rp 3.2 trillion (US \$348 million). Garuda will receive Rp 500 billion (US \$54 million) in 2006 and the remaining Rp 500 billion in 2007. Moein also added that Minister for State-Owned Enterprises Sugiharto should facilitate loan repayment by Garuda to state-owned oil company Pertamina. Separately, Ministry for SOE's Secretary General Said Didu reportedly said that Garuda actually needs US \$230 million to complete its restructuring.

### Selected Economic, Monetary & Financial Statistics

	Jun 06	Jul 06	Aug 06	Sep 06
CPI Inflation (YoY)	15.53	15.15	14.90	14.55
CPI Inflation (MoM)	0.45	0.45	0.33	0.38
Rp/USD Exchange rate <sup>1</sup>	9,300	9,070	9,100	9,235
30-day SBI Interest Rate <sup>2</sup>	12.50	12.25	11.75	11.25
Foreign reserves <sup>3</sup>	40.1	41.1	42.0	42.3
JSX Composite Index	1,310	1,352	1,431	1,534
Exports (USD billion)	8.5	8.8	8.9	
% Change (YoY)	15.1	16.4	17.13	
Import (USD billion)	5.7	5.4	5.6	
% Change (YoY)	1.3	2.4	2.6	
Trade Balance <sup>5</sup>	2.8	3.4	3.3	

*Source: Bank Indonesia, BPS*

*(1) Rp/USD, end of period*

*(2) End of period*

*(3) USD billions, end of period*

*(4) Jakarta Stock Exchange average daily transaction volume, in billions of shares*

*(5) USD billions*

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